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Pre-publication version

Fit for Purpose or Drowning in Details?

Institutional Evolution of the European Financial Sector Supervisory Authorities (ESAs) a Decade after the Global Financial Crisis

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Abstract: The de Larosi re reform package of 2009 officially established the three European financial sector supervisory authorities (ESAs), namely, the European Banking Authority (EBA), the European Securities and Market Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). Fully operational since January 2011, the three ESAs have been developing and enforcing the single supervision rule books in their respective sectors and issuing binding decisions to ensure greater regulatory consistency. Furthermore, since the 2008 global financial crisis and the subsequent Eurozone crisis, there have been several waves of new EU legislation in banking, securities and insurance, which have further expanded the powers, responsibilities and tasks of the three ESAs. Important revised and new legislation includes: the revised Capital Requirements Directive IV (CRD IV) and the recent Capital Requirements Regulation (CRR) in banking; the revised Markets in Financial Instruments Directive II (MiFID II), the recent Markets in Financial Instruments Regulation (MiFIR) and European Market Infrastructure Regulation (EMIR) in securities; and the revised Solvency II Directive in insurance. This chapter examines the institutional evolution of the three ESAs and how their roles have changed as a consequence of the global financial crisis and the Eurozone sovereign debt crisis.

Key words: European Supervisory Authorities (ESAs); EU financial sector; ESMA; EMIR; MiFID II; MiFIR

1. Introduction

The 2008 global financial crisis led to a severe economic downturn in advanced industrialised economies. Considering that weak financial sector oversight contributed to the crisis, there was an unparalleled opportunity for redesigning financial sector supervision in the European Union (EU) (FSA 2009; Moloney 2011a; Haentjens and Wessels 2015). A vantage point a decade after the financial crisis provides a good opportunity to assess the institutional developments in EU financial regulation and supervision. This chapter examines the impact of the 2008 global financial crisis and the subsequent Eurozone sovereign debt crisis on the institutional development of the three financial sector European Supervisory Authorities (ESAs), particularly focusing on the case of the European Securities and Markets Authority (ESMA). I investigate the tasks that the three ESAs have performed since their creation and how these have changed and expanded as a consequence of the global financial crisis and the Eurozone sovereign debt crisis.

In the overarching architecture of European financial sector governance, the three ESAs are the successors to three smaller networked committees of national supervisory authorities with limited decision-making powers – the so-called level 3 committees (Quaglia 2010). Set up as part of the *Lamfalussy* financial supervision reforms, the level 3 committees played an important role in exchanging best practices across member states and sectors, and in facilitating regulatory convergence (European Central Bank 2007; Grossman and Leblond 2011). However, they were only authorised to issue non-binding recommendations. In recognition of the need for further institutional reforms in EU financial supervision, the three level 3 committees signed a joint protocol on cooperation to ensure greater coherence and consistency as early as November 2005, well before the outbreak of the 2008 crisis. They pledged to share information more effectively, exchange experience, reduce duplication of reporting and issue joint reports and strategies for future development (European Central Bank 2007).

In the aftermath of the most severe global economic crisis since the Great Depression, and as part of the so-called 2009 *de Larosière* reforms, the three *Lamfalussy* committees became European supervisory authorities (ESAs), namely, the European Banking Authority (EBA), the European Securities and Market Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). Fully operational since January 2011, the three ESAs have been developing and enforcing the single supervision rule books in their respective sector and issuing binding decisions to ensure greater regulatory coherence. As we will see in the case of ESMA, now the ESAs can take decisions with a direct and binding effect on market participants and national supervisory organisations. Previously, this was not possible under the *Lamfalussy* framework.

The central argument in this chapter is that the crises affecting the EU's financial and economic order since 2008 created a momentum for centralisation of governance, as shown by the creation of new EU bodies and transfer of powers and competences from the member states to the EU level (see also Salines *et al.* 2012; Howarth and Quaglia 2016; Quaglia and Spendzharova 2017). Furthermore, since becoming operational in 2011, the three ESAs have received new responsibilities and powers to ensure harmonised rule application across the EU as a consequence of a series of incremental EU legislative reforms, where unintended consequences have been an important factor reinforcing the trend toward greater supranationalisation that started in 2008.

The chapter is organised as follows: section two outlines the evolution of the European financial sector governance framework and the role of the ESAs. Section three discusses the increasing powers of ESMA as a case study of the changing roles and tasks of the EU financial supervisory bodies. Subsequently, section four puts forward the analytical framework, focusing on the far-reaching effects of incremental institutional change in financial regulation and section five applies this framework to the case of ESMA. Finally, section six considers legal challenges taken up by the member states, in particular, the case brought by the UK against the Council and the European Parliament regarding the EU Regulation on Short Selling (case C-270/12) and section seven summarises the main findings.

2. The institutional evolution of EU financial sector regulation

This section starts with a brief overview of recent milestones in EU financial regulation, which helps to contextualise the increased powers of the European supervisory authorities. The first overarching policy at the EU level in the realm of financial markets and services was the Financial Services Action Plan (FSAP) covering the period 1999-2005. Due to its slow implementation, in 2000, the ECOFIN Council of Ministers appointed an expert committee, chaired by Alexandre Lamfalussy, to speed up EU-wide convergence in regulating securities markets. The so-called Lamfalussy financial supervision framework was adopted in 2002 after lengthy negotiations between the European Commission, Council, and Parliament. Subsequently, the principles outlined in the Lamfalussy report for the securities sector were extended to banking and insurance (Lannoo 2002; Quaglia 2007, 2010). In 2004, the European Commission reviewed the Lamfalussy process and engaged in extensive consultations to fine-tune its implementation. The Commission's White Paper on Financial Services 2005-2010 succeeded the FSAP in terms of providing an overarching vision for developing the single market in financial services (European Commission 2005; see also Masciandaro *et al.* 2009; Quaglia 2010; Grossman and Leblond 2011).

The three level 3 committees, namely, the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions (CEIOPS), were among the most innovative institutional features of the *Lamfalussy* financial supervision framework. They were set up to foster the exchange of best practices across member states and sectors, and to facilitate regulatory convergence (European Central Bank 2007; Grossman and Leblond 2011). However, they were only authorised to issue *non-binding* recommendations. In November 2005, the three committees signed a joint protocol on cooperation to ensure greater coherence and consistency. They pledged to share information more effectively, exchange experience, reduce duplication of reporting and issue joint reports and strategies for future development (European Central Bank 2007).

In the aftermath of the 2008 global financial crisis, the European Commission launched a new initiative to redesign the European financial architecture following the recommendations of another high-level expert group, chaired by Jacques de Larosière (see Hodson and Quaglia 2009; Quaglia 2010; Mügge 2010; Posner and Véron 2010). These reforms envisaged the creation of a European Systemic Risk Board (ESRB) in charge of macro-prudential supervision – monitoring and assessing systemic risk in European financial markets (European Commission 2009b). A second institution – the European System of Financial Supervisors (ESFS) – would complement the ESRB in the realm of micro-prudential

supervision. The ESFS includes the three new European supervisory authorities in banking, securities and insurance (European Commission 2009c; Amtenbrink 2011).

The first new institution, the European Systemic Risk Board, monitors risks to financial stability in the EU-28 and has been received by the member states fairly free of controversy. It is comprised of the 28 national central bank governors of the EU member states, the two top European Central Bank officials, as well as representatives of the Commission and the three newly-created European supervisory authorities. The second institution, the European System of Financial Supervisors, has caused more debate. The de Larosière reforms empowered the ESAs to issue decisions with binding power. While member states in favour of greater centralisation and harmonisation of financial regulation as well as the European Commission and Parliament welcomed the enhancement of the ESAs' powers, other member states voiced concerns about possible loss of national regulatory autonomy and potential fiscal burdens (Buckley and Howarth 2010; Mügge 2011; Spendzharova 2012, 2014; Spendzharova and Bayram 2016). These tensions become clear when we consider the case of ESMA discussed below.

3. The increasing powers of ESMA

ESMA is an integral part of the European System of Financial Supervision (ESFS), together with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the relevant national competent authorities of the EU member states. The central mission of ESMA is to 'enhance investor protection and promote stable and orderly financial markets' (ESMA 2016). This translates into three objectives: investor protection, orderly markets and financial stability (ESMA 2016). While investor protection has always been within the core mandate of national securities markets regulators, safeguarding financial stability is a novel addition to the objectives of securities regulators, which has come to their attention in the aftermath of the 2008 global financial crisis. Thus, as pointed out by ESMA's Chair, Steven Maijoor, in addition to its core investor protection mandate, ESMA has been very active in the field of financial stability (Maijoor 2016).

To achieve its mission and objectives, ESMA's activities fall in four core areas: assessing risks to investors, markets and financial stability; completing the single rulebook for EU financial markets; promoting supervisory convergence; and directly supervising some financial entities which are essential for the EU's financial markets infrastructure, such as credit rating agencies (CRAs) and trade repositories (TRs). As ESMA (2016) points out, these four types of activities are closely interlinked. Risk assessments are used as input for work on the single rulebook and supervisory convergence. Better supervisory convergence itself is seen as a desirable outcome of the single rulebook. Lastly, the direct supervision of CRAs and TRs provides information for ESMA's risk assessments and its single rulebook actions, and vice versa.

More than a decade after its predecessor, CESR, was set up, ESMA has gained and exercised a wide range of powers that substantially exceed CESR's competencies and even approximate those of its US counterpart – the Securities and Exchange Commission (SEC). To name the main powers of the agency, ESMA develops guidelines, recommendations and draft regulatory and implementing technical standards in the area of securities regulation. It can also issue opinions to the EU institutions, which is relevant for ongoing EU legislative negotiations in financial sector governance (Moloney 2011a; 2011b). Within its

responsibilities to promote convergence of supervisory practices across the EU, ESMA has powers to conduct peer reviews, identify best practices, mediate and resolve disputes between national competent authorities of the member states and cooperate with the ESRB in the field of systemic risk, especially risks stemming from financial innovation (see also Moloney 2011a; 2011b; Schammo 2011). Next, let us examine the relevance of incrementalism for understanding the recent EU reforms of financial sector governance.

4. Analytical framework: The far-reaching effects of incremental institutional change

Rational institutional design models of agency creation emphasise the ability of public actors to create or reshape institutions in order to best pursue shared public policy goals, such as financial stability. For example, Howlett & Rayner (2007, p. 7) have examined a variety of 'integrated strategies' in rational policy design, through which governments attempt to achieve 'coherent policy goals, relying on a consistent set of policy instruments that support each other in the achievement of the policy goals'. According to this model of agency creation, setting up new bodies and the delegation of powers is the result of deliberate and targeted choices by public actors (Howlett 2011).

By contrast, incrementalism is an alternative framework that can account for the institutional development of ESMA since its creation, drawing on the work of Charles Lindblom. He used the metaphor of the branch method to describe his approach, 'continually building out from the current situation, step-by-step and by small degrees', rather than starting from scratch every time decision-makers encounter a problem (Lindblom 1959, p. 81). Lindblom's analytical framework is particularly relevant for policy environments where decision-makers are faced with conflicting priorities and disagree about the most appropriate course of action. Such constraints become all the more evident and important in fragmented multi-layer systems of decision-making such as the European Union. The simple rank ordering of policy alternatives is not feasible, and policy actors often neglect important possible outcomes and alternative policies. In the end, policy adjustment tends to occur in the margins because decision-makers 'simultaneously choose a policy to attain certain objectives and choose the objectives themselves' (Lindblom 1959, p. 82).

Incrementalism entails policy adjustments in the margins. At the same time, Lindblom has stressed in his later work that 'incrementalism in politics is not, in principle, slow moving...not necessarily, therefore, a tactic of conservatism' (Lindblom 1979, p. 520). He even suggested that a fast-moving sequence of small changes could bring about a substantial change in the status quo. This may very well be what we are currently observing with the growing powers and prominence of ESMA in European financial sector governance.

In complex decision-making involving many actors, the 'best' policy emerges not out of a comparison against an abstract ideal, but out of a pragmatic agreement on a policy that is acceptable to all parties (Lindblom 1959, p. 82). This aspect of Lindblom's work is especially relevant for understanding collective action in the EU. While Lindblom's incremental model of policy change is derived from a pluralist system of interest representation, such as the USA, it applies well to the current multi-level system of EU decision-making, where supranational, national, and subnational interests, as well as organised business, other stakeholders and labour shape policy together.

In addition to those aspects of incrementalism, Lindblom emphasised a cognitive component. Decision-makers focus on a few policy alternatives only marginally different from

the status quo, because this approach makes the most of existing knowledge and their ability to anticipate the future consequences of their most preferred policy. Otherwise, when there are too many moving pieces, one cannot credibly predict the actual impact of policy change. The literature on bounded rationality has developed this insight further. Decision-makers often have to generate the possible policy alternatives themselves and define them according to their understanding of the problem at hand (Simon 1979; 1996). More recently, public policy scholars have shown that actors tend to have ready policy solutions which they put forward when a window of opportunity opens, often created by a crisis or policy failure (Cohen *et al.* 1972; Kingdon 1996). In response to the powerful critique by scholars of incrementalism and bounded rationality, recent work in rational choice institutionalism has developed a more nuanced understanding of rationality, taking into consideration the cognitive constraints of decision-makers.

Drawing on the cognitive aspect of partisan mutual adjustment, Lindblom's work on incrementalism can be used to shed light on how decision-makers overcome collective action problems in the EU. Committed to the overarching project of completing the single market in financial services, most EU member states would find a common set of financial regulation rules to be more optimal than the perpetuation of a myriad of national regulations. Yet what kind of harmonised policy could satisfy the member states and the EU institutions involved in negotiating new legislation?

5. Incremental institutional upgrading of the European supervisory authorities: the case of ESMA

Drawing on the case of ESMA, I argue below that expanding the decision-making powers of level 3 Lamfalussy committees emerged as a key focal point of the early discussions on reforming EU financial sector governance. However, these institutional reforms became politically feasible only after the 2008 global financial crisis and gained further momentum during the Eurozone sovereign debt crisis.

In 2010, the EU institutions adopted the ground-breaking Directive 2010/78/EU, also known as the Omnibus I directive, which spelled out the new supervisory framework and main powers of the ESAs, including ESMA. The following year, they passed another directive, Omnibus II, that empowered the ESAs even further. Figure 3 presents an overview of the incremental increase of ESMA's powers since 2011 through new and revised EU legislation in the realm of developing draft technical and implementing standards in securities regulation, market transparency and investor protection as well as post-trading.

The adoption of recent financial markets legislation, such as the European Market Infrastructure Regulation (EMIR, 2012), the revised Markets in Financial Instruments Directive (MiFID II, 2014) and Markets in Financial Instruments Regulation (MiFIR, 2014) shows an incremental trend over time toward reinforcing and expanding ESMA's powers as a European financial sector regulator. As shown in Figure 3, EMIR (2012) expanded ESMA's powers in the realm of post-trading. Subsequently, the Regulation on Short Selling and Certain Aspects of Credit Default Swaps (2012) reinforced ESMA's powers in ensuring market integrity and transparency. The agency's market integrity and investor protection powers were further expanded in 2014 by the Market Abuse Regulation (MAR). Lastly, four substantial pieces of legislation expanded ESMA's powers in the realm of drafting regulatory technical standards (RTS) and implementing technical standards (ITS). These are the Markets in Financial

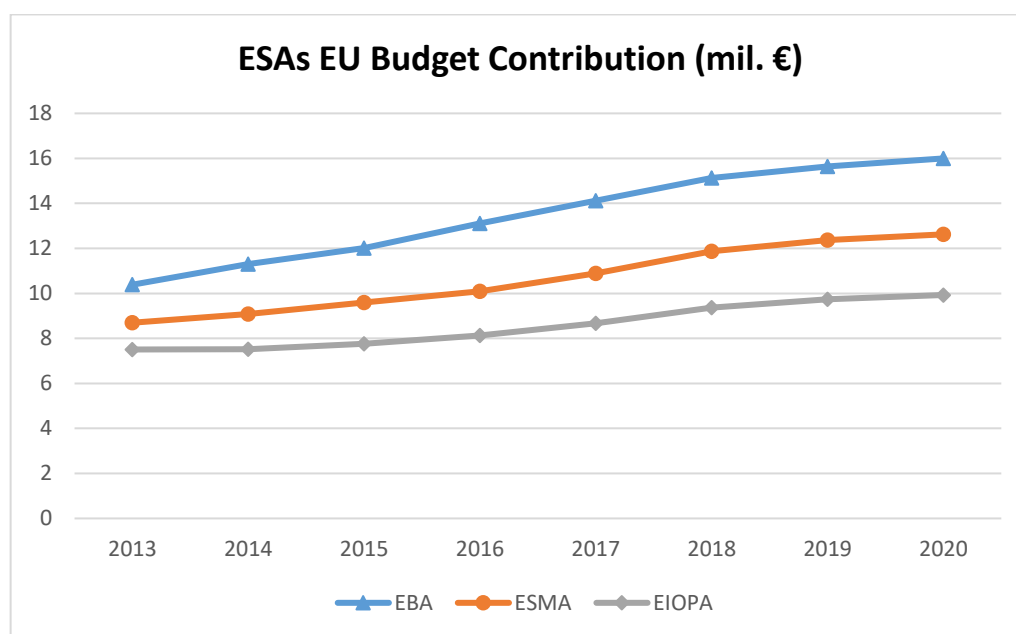
Instruments Regulation (MiFIR, 2014), Market Abuse Regulation (MAR, 2014), EU Benchmarks Regulation (2015) and (Securities) Prospectus Regulation (2017).

Moreover, ESMA has a wide range of implementing tasks for existing (and amended) legislation in the realm of securities regulation, such as the Prospectus Directive (2003, amended 2010) and the newly adopted Prospectus Regulation (2017), the Transparency Directive (2003, amended 2013), the UCITS Directive (2009, amended 2010, 2011, 2013, 2014) and the AIFMD Directive (2011).

With respect to financial and staff resources available to the ESAs, including ESMA, to carry out their rapidly expanding set of tasks and responsibilities, as shown in Figures 1 and 2 below, the ESAs' total budgets have more than doubled during the first years of their operations, with an average growth rate of more than 25% per year (European Commission 2017: 164). On the one hand, the budgetary growth was factored in the amounts earmarked for the ESAs in the EU's Multiannual Financial Framework 2014-2020 to ensure the implementation of the single rule books in their respective sector. The estimates also show that no substantial budgetary growth can be accommodated from 2018 onwards.

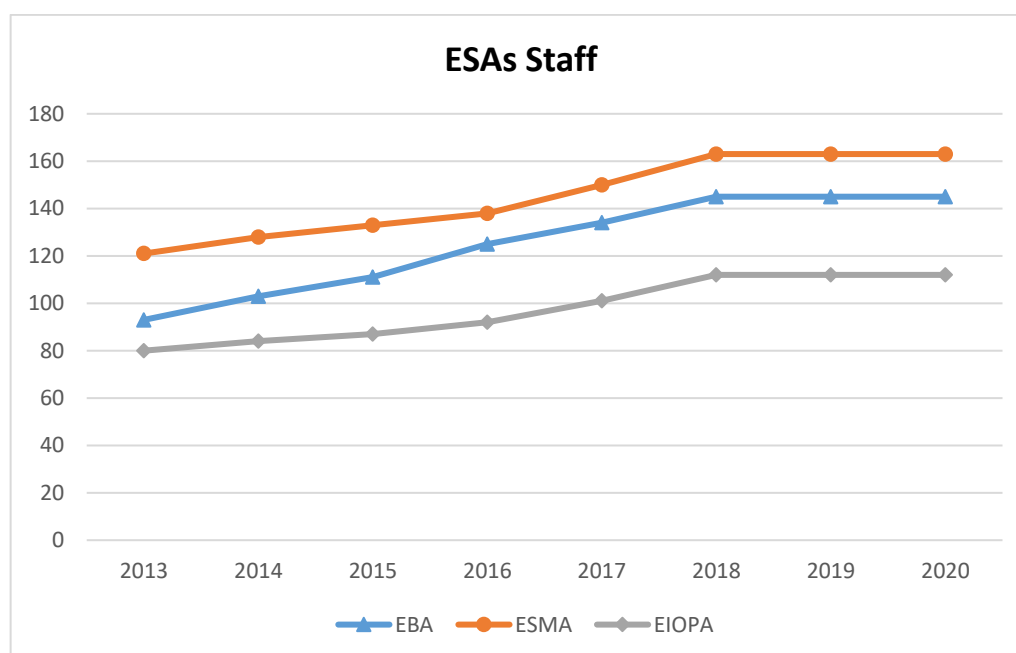
On the other hand, in line with an incrementalist account, it seems that the new tasks and demands placed on the ESAs, including ESMA, surpass their current resources. For example, due to budget constraints, ESMA had to remove from its IT Work Programme 2017-2019 the development of the European Electronic Access Point (EEAP) in favour of the implementation of the Prospectus Directive and Money Market Funds Regulation projects, even though both actions are required from ESMA under the current EU legislation (European Commission 2017, p. 165). Furthermore, staff testimonies before the EU Parliament show that the ESAs have difficulties in meeting their objectives in a number of crucial areas such as assessments of third country equivalence, consumer protection and supervisory convergence (European Commission 2017, p. 165).

Figure 1: ESAs budget contribution from the EU budget, MFF 2014-2020



Source: European Commission (2017)

Figure 2: ESAs total number of staff employed



Source: European Commission (2017)

Table 1: Budget of the ESAs, 2016 (in million €)

ESA	EU CONTRIBUTION	MEMBER STATES CONTRIBUTION	DIRECT INCOME FROM SUPERVISED BODIES	TOTAL ESA BUDGET
EBA	14,7	22,4	0	37,1
ESMA	10,2	16,2	10,5	36,9
EIOPA	8,3	13,3	0	21,6

Source: European Commission (2017)

As ESMA is a de facto European agency, it is important to relate the argument developed in this chapter about the incremental increase in powers of EU agencies to general explanations of agency formation (Busuioc *et al.* 2012; Busuioc 2013; Rittberger and Wonka 2015; Egeberg and Trondal 2016; Bach *et al.* 2016). Groenleer (2011) puts forward three widely used accounts of agency creation in the literature – functional, political and transnational policy diffusion. According to functional explanations, regulatory divergence across the Union and growing pressures on the Commission’s resources lead to setting up independent agencies. Agencies bring together independent expertise at the EU level, increase the transparency and visibility of EU policymaking, and reduce transaction costs for national governments (Groenleer 2011; see also Dehousse 1997; Majone 1996). According to political explanations, agencies demonstrate decision-makers’ credible commitment to optimise collective action arrangements and improve the regulatory environment, especially in the wake of a crisis (Kelemen 2002; Shapiro 1997; Kelemen and Tarrant 2011). Lastly, policy diffusion explanations emphasise that, in the past two decades, governments have set up a large number of independent regulators at the domestic level. This institutional design has been emulated at the European level. In this context, European agencies are complementary to the national regulatory authorities and act as a hub for regulatory cooperation (Dehousse 1997; Chiti 2000; Egeberg and Trondal 2009; Levi-Faur 2011). In a similar vein, Yesilkagit and Christensen (2010) have tested two main explanations of the institutional design and formal autonomy of national regulatory agencies in Sweden, the Netherlands, and Denmark – historical-cultural and political ones. All in all, Groenleer (2011) notes that, overall, ‘most [European] agencies have a limited mandate...and only a few agencies have been granted decision-making tasks’.

Against this backdrop, this chapter sheds light on the factors that made possible the creation and further delegation of powers to ESMA as a powerful European regulator. In order to trace the process of institutional reform, I draw on official reports evaluating the Lamfalussy and de Larosi re frameworks, triangulated with official documents, the academic literature and systematic press coverage. In particular, several expert committee assessments of the Lamfalussy financial regulation framework, as well as ECOFIN Council conclusions, show the build-up of functional pressures, especially in the mid-2000s, to enhance the powers of level 3 committees and pursue greater regulatory coherence across the Union. Next, I discuss the conclusions and recommendations of those reports in greater detail.

The first comprehensive review of the Lamfalussy framework in 2004 resulted in a positive assessment by ECOFIN and the extension of the general approach from securities to all financial services sectors. We can glean experts’ reasoning from the regular reports of the Inter-institutional Monitoring Group (IIMG) which was responsible for assessing the

implementation of the Lamfalussy process and identifying bottlenecks. Convened in 2003, the IIMG was reconstituted in 2005, following the extension of the Lamfalussy process to all financial services. The IIMG highlighted that European financial markets had changed considerably and new issues needed to be addressed (IIMG 2007, p. 6). For example, regulators increasingly had to oversee the activities of large cross-border European financial groups. These market developments called for stronger coordination between the national supervisory authorities and more consistent application of EU rules across the member states to realise the full benefits of the single market (IIMG 2007, p. 13).

The expert committee reports provide evidence of a gradual increase in the powers of the three Lamfalussy supervisory committees. The initial focus of the committees' work was on providing expert advice in the preparation of urgent sectoral legislation such as the Capital Requirements Directive (CRD), the Markets in Financial Instruments Directive (MiFID) and the Solvency Directive. Later on, as member states started the implementation process, the convergence tasks of level 3 committees came to the foreground, and so did the question of their powers (FSC 2007, p. 6). Level 3 committees faced mounting challenges due to the increased speed of market integration and growing prominence of financial conglomerates. In this new environment, the committees acquired new tasks, and their supervisory discretion grew over time. After all, level 3 committees were the only European bodies that had both the staff and prior experience to handle the new regulatory pressures (FSC 2007: 8). The sunk costs of establishing and funding the committees as well as increasing returns of promoting supervisory convergence served as a constraint on any alternative options for an institutional redesign. In sum, we do observe some enhancement in the supervisory discretion of level 3 Lamfalussy committees due to functional pressures, referring to Groenleer's (2011) analysis. Yet this occurred without changing the committees' legal basis and within the framework of issuing non-binding decisions, which suggests some political backlash against these functional pressures and the presence of actors wishing to constrain the independent decision-making powers of agencies (see Kelemen and Tarrant 2011; Busuioc 2013).

The first reviews of the Lamfalussy process also show that a positive feedback effect supported the institutional development of level 3 committees. They were largely seen to perform their tasks well and live up to the expectations of both the member states and EU institutions. The IIMG applauded their important advisory work and stressed that they had fully met their original mandate (IIMG 2007, p. 15). Based on its positive assessment of the committees' performance, the IIMG recommended 'a considerable uplift in their resources...which may require changes to the level 3 committees' legal base or status within the EU system' (IIMG 2007, pp. 18-19). However, the IIMG also stressed that its members were divided about the need for such further empowerment. Thus, despite the presence of a positive feedback effect supporting the further transfer of powers to level 3 Lamfalussy committees, important EU policy actors were not convinced that this step was necessary.

The redesign of European financial regulation unfolded in a political environment where discretion in enforcement was relatively low, and the policy process was dominated by strong veto players – each of the EU's legislative institutions could thwart the reform process. In this institutional environment, the literature on incrementalism would anticipate small gradual changes over time rather than bold institutional redesign in one go. Consistent with this expectation, the outcome of the de Larosi re institutional redesign shows evidence of incremental institutional reform. The European supervisory authorities, such as ESMA, are an upgrade of level 3 committees, but we also observe a very close correspondence in terms of

their core mandate, staff, and location. Furthermore, in the case of ESMA, three (out of six) important pieces of EU legislation shown in Figure 3 which conferred more powers to the agency after it became operational in 2011 are amended versions of existing EU directives or regulations, such as MiFID II and MiFIR and the Market Abuse Regulation (MAR) which replaced the 2004 Market Abuse Directive (MAD).

By 2017, all ESAs, and ESMA in particular, have gained more binding powers and tasks compared to their predecessors in spite of opposition from some member states. We find the greatest preference heterogeneity about the new European financial supervision architecture in the Council. The European Commission and Parliament clearly favoured a further transfer of powers to the European supervisory authorities in order to enhance regulatory convergence in the Union and ensure stronger sanctions in case of failure to comply (EurActiv 2009b; Financial Times 2009; EurActiv 2010; Tait 2010). By contrast, member states' preferences about this issue diverged, with some member states such as the UK being watchful about preserving national regulatory autonomy (see also Buckley and Howarth 2010; Grossman and Leblond 2011; Spendzharova 2012).

Public stakeholder consultation position papers from the mid-2000s provide further evidence of these disagreements (see for example European Banking Federation 2009; Hungarian Financial Supervisory Authority 2009; Luxembourg Bankers' Association 2009). In January 2007, the Inter-institutional Monitoring Group invited all interested parties to comment on its second interim report on the Lamfalussy process. It received 34 reactions from the main stakeholders, such as national and EU level industry associations, member states' central banks, financial regulation agencies and finance ministries, banks and financial companies. The consultation revealed that a number of stakeholders saw a problem in the existing incentives for the members of level 3 committees to follow predominantly national interests. To correct this perceived shortcoming, they proposed that level 3 committees should be able to take binding decisions based on a majority vote. This, in turn, would encourage supervisors to take a pan-European view rather than a national one (IIMG 2007, p. 26).

A major tipping point toward giving the European supervisory authorities greater regulatory powers occurred in 2009, following the 2008 global financial crisis. In the June 2009 ECOFIN Council meeting, member states agreed to give the ESAs powers to take binding decisions in order to promote harmonised and consistent supervision of financial institutions across the EU (Council 2009a: 4-6). However, the UK led a coalition of member states demanding the adoption of the so-called 'triple-lock' safeguard mechanism, which provided the member states with multiple appeal mechanisms to contest decisions taken by the ESAs (EurActiv 2009a; EurActiv 2009c). The three steps of the 'triple-lock' mechanism are summarised as follows: as a first option, a member state can appeal a decision before the ECOFIN Council of Ministers. A simple majority of at least 14 member states can then overturn that decision. The second level is an appeal before the Court of Justice of the European Union. Third, as a last resort, a country can also appeal a decision before the European Council (EurActiv 2009a; EurActiv 2009c). The October 2009 ECOFIN Council conclusions built up on the June 2009 decision and provided a detailed roadmap for the EU regulatory framework (Council 2009b).

The European Commission launched its proposal for a directive specifying the powers of the three European supervisory authorities (2009/0161 COD) in October 2009, which was then

discussed by the Council in July 2010 and passed first reading in the European Parliament in September 2010. The Parliament's amendments further bolstered the European mandate of the ESAs, especially when it comes to overseeing cross-border financial institutions and imposing legally-binding mediation on national supervisory bodies or colleges of supervisors. Furthermore, MEPs gave the ESAs a stronger consumer protection profile: the ESAs gained powers to investigate specific financial institutions if they posed a significant risk to the European financial market. The Parliament also achieved its priority to have veto power over the appointment of the ESA chairpersons (EurActiv 2010; European Parliament 2010). Overall, the amendments introduced by the European Parliament increased further the powers of the European supervisory authorities and their supranational profile. Within a month, the Council approved the Parliament's amendments. That, in turn, paved the way for the official adoption of the three European Union Regulations (1093/2010, 1094/2010, 1095/2010) that set up the European supervisory authorities and European Union Directive 2010/78/EU that specified their powers in November 2010.

Since then, the Commission has carried out two formal rounds of policy evaluation of the ESAs, in 2014 and 2017, confirming that they are fulfilling their mandate as expected, but also emphasising the need for greater financial resources than originally anticipated (European Commission 2014, 2017). The latter point was very pressing in the case of ESMA in the 2017 Commission evaluation, which indicates that the EU institutions had not anticipated the extent of new tasks and demands that would be placed on ESMA after its creation in 2011.

6. Challenges by the EU member states: CJEU case C-270/12 about EU short selling rules

As we have seen so far, since its creation in 2011, ESMA has gained extensive powers to regulate European financial markets. At the same time, some EU member states, which from the very outset had reservations about preserving sovereignty in key areas of decision-making, have kept a close watch on the growing powers of EU agencies, as this has important implications for national regulatory autonomy. This concern was clearly manifested in June 2013 when the Court of Justice of the EU (CJEU) heard a legal challenge to the EU Regulation on Short Selling in the case 'C-270/12, United Kingdom of Great Britain and Northern Ireland v. Council of the European Union, European Parliament'. The UK's government filed the legal challenge in 2012, aiming to curtail the powers of ESMA to stop or limit short selling across the 28 EU member states in the event of a crisis. Considering general developments in EU governance, the legal challenge before the CJEU was not unprecedented. The Court had already been involved in adjudicating cases dealing with scientific uncertainty and complexity (see Vos 2013). Nevertheless, the short-selling case was a crucial test whether ESMA's expanded powers would withstand judicial scrutiny.

The case brought up by the UK government refers to Article 28 of the EU Regulation on Short Selling (SSR) which provides ESMA with powers to intervene directly in financial markets in exceptional circumstances, for example, when the 'orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union are threatened' (Art. 9(5) SSR). The article enables ESMA to prohibit or place conditions on 'entering into a short sale' or 'entering into other transaction in a financial instrument that confers a financial advantage in case of a decrease in value of another financial instrument' (but this does not apply to sovereign debt and sovereign CDS). It is important to note that this type of intervention is not aimed at harmonisation of the single market in financial services,

but at safeguarding financial stability. According to Commission official Bernardus Smulders, 'the objective of those interventions is clearly one to ensure financial stability'. Furthermore, Anders Neergaard, a European Parliament official clarified that ESMA must 'be able to show that there is a threat' to financial markets before taking any decisions, which further ensures that the agency would not act in an arbitrary manner (Smulders and Neergaard cited in Bodoni and Brunsden 2013).

The UK government questioned whether ESMA had the legal power to impose short selling bans if the member states' national regulators did not see the need for such a ban. The legal case tested the boundaries of the so-called 'Meroni Doctrine', which governs the allocation of powers between the supranational EU level and the national level of the member states in the absence of specific treaty provisions. Going back to 1958 Meroni case (Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community), at that time, the Court stressed that the discretionary delegation of powers to EU agencies or similar independent bodies should not infringe the 'principle of institutional balance' between the Community and the member states.

Pelkmans and Simoncini (2014, p. 2) have clarified the essentials of the Meroni doctrine, as applied to the short selling case. The EU Member States have delegated powers to the EU level, and it cannot be assumed that 'any such powers can, in turn, be delegated to (say) an EU agency without an explicit decision, although an explicit Treaty base is not indispensable.' If powers are delegated, they cannot be so wide that the 'margin of discretion may lead to the execution of actual economic policy' (Pelkmans and Simoncini 2014, p. 2). Under EU law, the body to which powers have been delegated should not make discretionary choices about the execution of policy, as this alters the 'institutional balance' in the Union. According to the UK government, ESMA's powers to ban short selling constitute such a 'wide discretion', thus contradicting the Meroni doctrine. In addition, the UK government argued that the new powers of ESMA contradicted a principle set in the Romano case (C-98/80) concerning the prohibition on administrative bodies to adopt measures of general application with the force of law (see also Chamon 2011; Pelkmans and Simoncini 2014).

The CJEU, however, ruled against the UK government. The Court's assessment stated that in the broader context of financial stability, the additional powers for ESMA were warranted, especially because those powers were limited in significant ways in the relevant regulation. Advocate General Niilo Jääskinen also stressed that principles such as Meroni and Romano should be interpreted in light of the new EU constitutional framework after the Lisbon Treaty. Jääskinen (2013) emphasised that the Lisbon Treaty has introduced important safeguards that allow the EU co-legislators to lawfully delegate regulatory powers to EU agencies, such as Arts 263 and 277 TFEU on judicial review. Therefore, the Advocate General emphasised that if delegation complied with the legal guarantees set by the current context of the treaties, no dangerous (and unlawful) shift of responsibility would occur (Jääskinen 2013). In line with this interpretation, the CJEU concluded that EU agencies:

Have a high degree of professional expertise and work closely together in the pursuit of the objective of financial stability within the Union. ... Therefore, Article 28 of Regulation No.236/2012 ... cannot be regarded as undermining the rules governing the delegation of powers laid down [in the FEU Treaty] (CJEU 2013, paras 85-86).

7. Conclusion

Since 2011, the three financial sector ESAs, and particularly ESMA, have become established regulators in EU financial sector governance. This chapter put forward an incrementalist institutional explanation of the observed trend toward greater supranationalisation to complement explanations focusing on rational institutional design after crises. Nevertheless, some EU member states, which from the very outset preferred to preserve national regulatory autonomy, have kept a close watch on the expanded powers of ESMA, in particular, and EU agencies and agency-like bodies in general. One important example illustrating this dynamic is the CJEU case brought up by the UK government in June 2013, which challenged the powers of ESMA to impose a ban on short selling. These powers could be used by ESMA to overrule a member state's national securities regulator. The CJEU's decision in the short selling case shows that, so far, the concerns about financial stability at the EU level have been paramount and, thus, the post-crisis trend to centralise and consolidate the powers of the ESAs in European financial markets regulation has persisted.

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Figure 3: Incremental Increase of ESMA's Powers

